THE LIES COMPANIES TELL, BY PAUL H. WEAVER

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THE MAN WHO OUTSMARTS MADISON AVENUE

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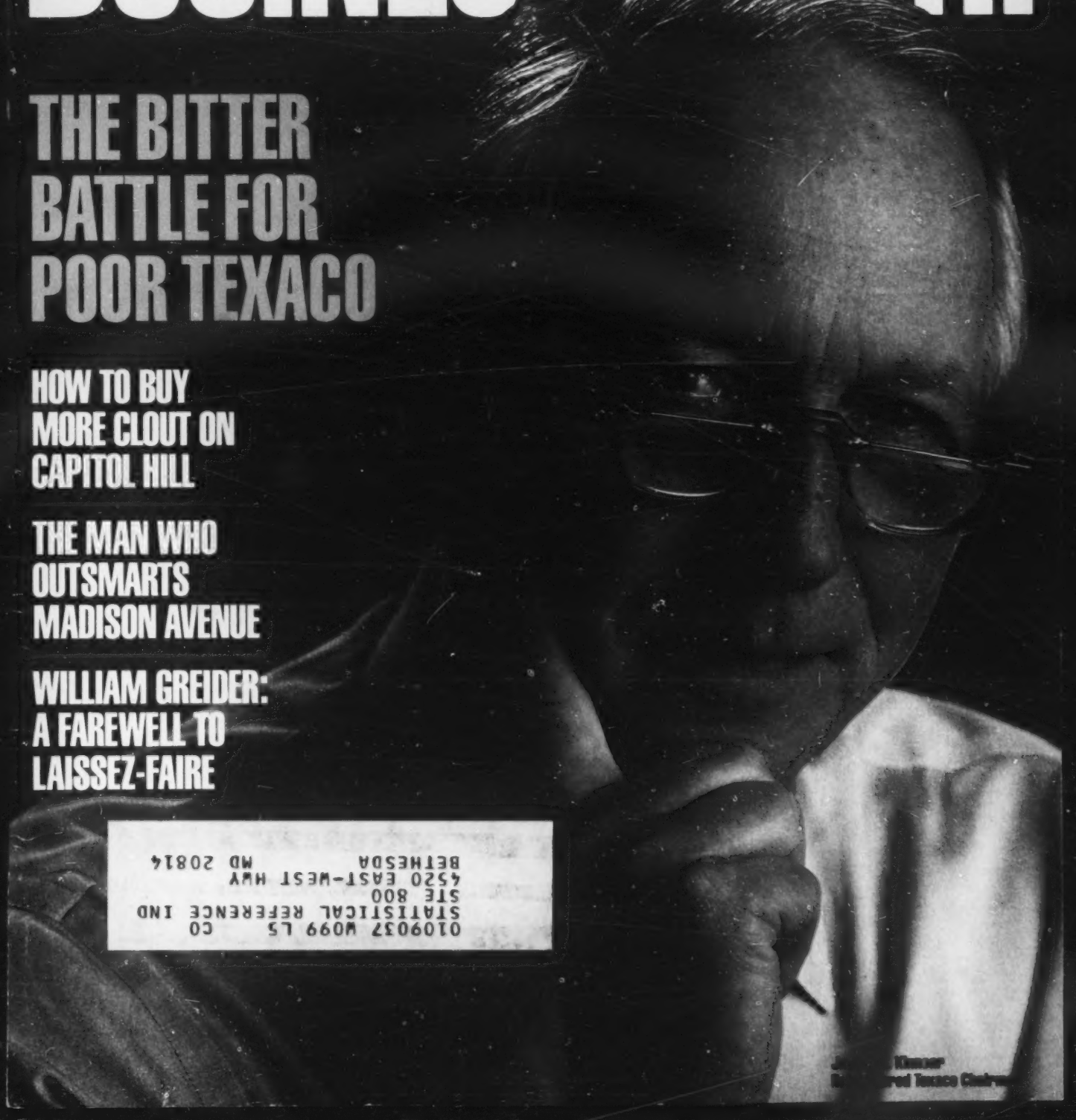

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LETTERS

ROSTOW'S VISION

Your good sense in recruiting the ideas of Walt W. Rostow for insight into the future ("Danger and Opportunity," January) was fine journalism and rewarding reading at a time of intense concern.

Rostow's leadership roles during the Kennedy-Johnson years has never been fully told. Having traveled with Rostow in 1968 during President Johnson's visit to Central America, I quickly recognized his enormous wisdom and sound judgment. Historians may remember that Rostow was LBJ's national security adviser and that he took his lumps because of the Vietnam war. Seeing the caliber of men who followed Rostow in the job, I have felt that the nation was the loser in his move from the center of policy to academe.

JOSEPH H. CARTER
Vice President
Office of Information Services
Cameron University
Lawton, Oklahoma

VERMONT DID IT FIRST

The item "Once More, California" (The Month in Perspective, February) says that the recent increase in the minimum wage in California is "the first at either the state or the federal level in seven years."

Not so. The Vermont Legislature increased the minimum wage by 10 cents in 1985 to become effective on July 1, 1986. The minimum wage went up by another dime last July 1 and will increase to $3.65 per hour this summer.

JAMES H. DOUGLAS
Secretary of State
Montpelier, Vermont

AN EXPLANATION

Having read Ben J. Wattenberg's article ("Their Deepest Concerns," January), I have to agree that American businesses are entirely into short-term planning. The reason, as I see it, is greed.

With the exorbitant salaries and bonuses that some CEOs are taking home, the trend of thought is that they must make a good showing for their stockholders. Otherwise, they will hold their positions only for a year or two.

RICHARD B. CAMMARANO
Milford, Connecticut

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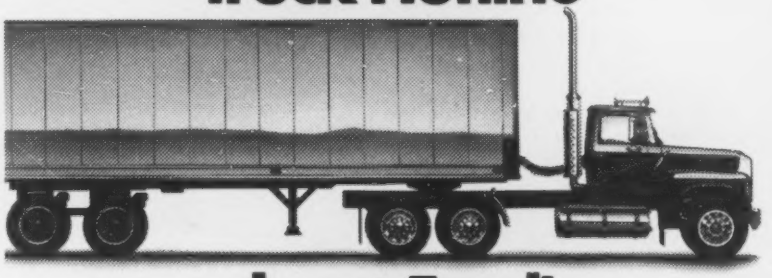

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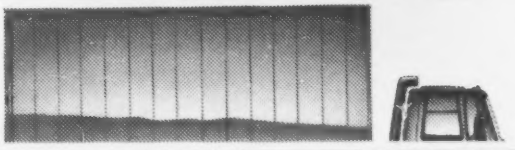

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Western hemisphere, and a major Dresser plant is only about 20 blocks away from the big Caterpillar Tractor plant in Peoria.

Even if Komatsu decides to produce in Peoria, analysts say, the American company is in a strong position. "Cat's product line is a generation ahead of Komatsu's," says Larry D. Hollis of Robert W. Baird & Company, a Milwaukee-based securities firm. Whether Komatsu produces in Japan or the United States, he says, "Cat now holds the enviable competitive position."

—L.A.

HOUSTON TRAILS IN THE SPACE RACE

At an average price of $122 per square foot, London has the most expensive Class A office space of a major city in Europe and North America, while Houston and Denver, at $12 per square foot, have the cheapest, according to a survey by the Office Network, a Houston-based research firm. The most expensive in the United States is Manhattan, at $40 a square foot.

Houston, not surprisingly, has the highest vacancy rate in North America, a whopping 31.8 percent, while Toronto is the tightest market at 8.4 percent. There has been a lot of speculation that New York's real-estate market will collapse in the wake of the Wall Street crash, but Stephen Marmion, president of the Office Network, says that "We don't see the vacancy rate rising to unmanageable levels."

—LAUREL BRUBAKER CALKINS

OFFICE RENTS IN MAJOR CITIES
(Europe and North America)

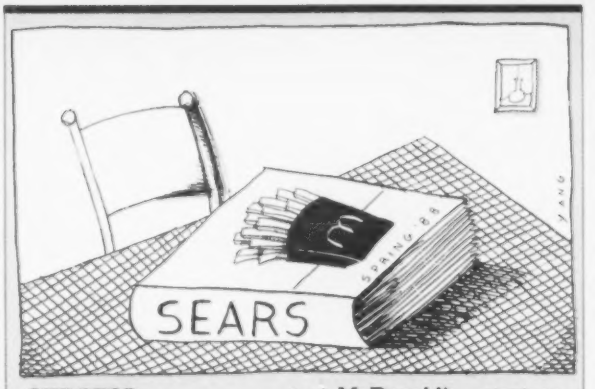
City	Rent Per Square Foot Class A building
London	$122.66
New York City (Manhattan)	40.00
Frankfurt	35.51
Boston	35.00
Vienna	34.39
Los Angeles	34.00
Toronto	33.86
Washington, D.C.	32.00
Miami	29.00
Chicago	28.95
Stamford	27.00
Munich	26.28
Hamburg	25.92
Amsterdam	25.80
Minneapolis	24.50
San Francisco	23.65
Philadelphia	22.10
Atlanta	21.38
Dallas	21.27
St. Louis	19.50
Kansas City	19.00
Pittsburgh	18.59
Cologne	17.76
Memphis	14.50
Houston	12.00
Denver	12.00

Source: The Office Network

HYUNDAI WOOS ITS OWN CUSTOMERS

To support its sharply rising American sales, South Korea's Hyundai Motor Company said last month that it would build a parts-distribution center—its fourth in the United States. "If we can't provide replacement parts on time, we risk losing repeat business," says Edward Kade, a Hyundai spokesman. Repeat business will be the key to Hyundai's success in the United States. With American small cars now competitively priced, Hyundai must find a way to hang on to its former customers if it is to continue to increase sales.

Last year, Hyundai's sales in the United States hit 263,610 units, up from 168,882 cars in 1986, the company's first year in the American market. This year Hyundai hopes to sell 300,000 automobiles. According to Arvid F. Jouppi, an analyst at Keane Securities Company, it has a good chance. "Early indications are that Hyundai buyers really like the car, are recommending it to their friends and are thinking of buying another Hyundai when their current one wears out," he says. *—L.A.*



ONE-STOP SHOPPING

Sears, Roebuck and Company and McDonald's Corporation are discussing the idea of bringing the golden arches to Sears stores. From Sears' viewpoint, having the restaurant on the premises would keep shoppers in the store. A pilot McDonald's is already operating in a Sears store outside Pittsburgh.

McDonald's strategy goes deeper. According to Diane L. Mustain, an analyst with Duff & Phelps Inc., "McDonald's is finding it more and more difficult to come up with winning locations." The nation's number-one fast-food outfit has been experimenting with restaurants in such nontraditional places as hospitals and airports—and soon, perhaps, department stores. *—L.A.*

SO THE PIPER WON'T GET PAID

A plan to alleviate the debt problems of the developing world, which was put forth last month by James D. Robinson 3d, chairman of American Express Company, has been greeted with a shrug by both the banks and the Reagan administration.

Robinson would create a new organization—backed by the governments of the primary lenders—to buy the mounting debt. But, says Robert G. Dederick, chief economist at Northern Trust Corporation and a former under secretary of commerce in the Reagan administration, "Governments, including this one, have been unwilling to put up the funds." With the World Bank and International Monetary Fund already in place, Dederick and others also question the need for a new organization. "The case-by-case approach being used has not been so unsuccessful that it creates a crying need for a new facility," he says. *—L.A.*

IRWIN JACOBS'S NEW DIRECTION

Irwin Jacobs, the Minneapolis-based raider, used to inspire fear among the denizens of Wall Street. But now, after unsuccessful runs at such companies as Borg Warner and ITT, the fear has largely abated, to be replaced by puzzlement. What is this guy doing?

Jacobs has gone through a dizzying spate of maneuvers to enhance the value of his companies. Nearly two years ago, he packaged together Minstar

Fear of Irwin Jacobs has been replaced by a sense of puzzlement.

NO MORE WHITE SHOES

As the Big Eight branch out, they are competing like street vendors for corporate clients. You might wonder how objective their audits can be. Good question.

BY MARK STEVENS

In the summer of 1984, Joseph Connor and Michael Cook, managing partners of the Big Eight accounting firms Price Waterhouse and Deloitte Haskins & Sells, hatched a plan that startled their competitors and surprised their clients. In a move unprecedented for the behemoths of the certified public accounting profession, white-shoe Price Waterhouse and once-stodgy Deloitte Haskins & Sells announced their intention to combine their practices, creating the largest accounting firm in the world.

To Connor and Cook—the former a hard-nosed manager, the latter an aggressive fast-tracker who had just come to power—the idea was inspired. It would propel their firms to the front of the Big Eight pack in revenues, fees and clients. Long considered the world's most prestigious accounting firm, Price Waterhouse would back up its clout with capital.

Or so thought the two masterminds. Confident that the deal would be done, they dispatched senior members of their firms to work out the details of the merger—including the sharing of confidential marketing information—even before the full partnerships voted on the proposal. But they were in for a surprise. When the vote was tallied in December 1984, Price Waterhouse's partners in the United Kingdom turned thumbs down on Price Waterhouse Deloitte. Faced with this veto from a major component of PW's international practice, the deal died.

Although the scheme fizzled, the economic pressures that spawned it have not, which is why many accounting executives believe that the Big Eight is overdue for a consolidation wave that will forever change the face of the profession. "In the next three or four years, you'll see a spate of mergers that are likely to transform the Big Eight into a smaller group of giants," says Ken Solomon, partner in charge of the Chicago office of ninth-ranked Laventhol & Horwath. "After so many years of building a mystique around the term Big Eight, they'll have to change it to something like the Big Five or Big Three or even the Big Two."

> THE MAJOR ACCOUNTING FIRMS ARE PAST DUE FOR A MERGER WAVE.

The implications extend beyond the accounting firms to the corporate clients they serve. Should consolidation occur, limiting competition and concentrating power in the hands of a few enormous firms, fees will probably rise, quality may slump and long-standing client relationships will come unglued. What's more, the cultures that defined the firms for generations, cultures that clients have used as guideposts for hiring one firm over another, may be lost to homogenization.

Indeed, that transformation is already under way. More than a century after their founding—most as chartered accountants in the United Kingdom—the larger accounting firms have evolved into enormous professional-service organizations. While all of the Big Eight cling to their heritage as "certified public accountants," a close look reveals that they are no longer accounting firms at all. Much of their income and profits comes from corporations and government agencies, for work that can include managing hospitals, preparing airport feasibility studies and arranging corporate mergers and acquisitions. Name a white-collar service and chances are that the Big Eight provides it.

The Big Eight accountants have shed their green eyeshades and transformed themselves into management consultants. Touche Ross has done prison-reform studies for the Colorado Division of Correctional Services; Coopers & Lybrand installed management-information systems for the Indonesian railways; Price Waterhouse advised the U.S. Bureau of Indian Affairs on the delivery of services to Native Americans; Peat Marwick conducted a feasibility study for the midfield terminal at Atlanta's Hartsfield International Airport; and Deloitte Haskins & Sells helped the U.S. Comptroller of the Currency tighten its regulation of the banking system. "If you take a close look, you see that at the Big Eight, the audit is becoming incidental," says Alan Westheimer, a partner with Pannell Kerr Forster, the 14th-ranked accounting firm, and a former chairman of the professional services marketing committee for the Texas Society of CPAs. "These are accounting firms that

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Mark Stevens is the author of The Big Eight: An Inside View of America's Eight Most Powerful and Influential Accounting Firms *and* The Accounting Wars.

ILLUSTRATIONS BY DAVID SHANNON

are rapidly turning into consulting firms."

Why the change? How and why did the Big Eight transform themselves from bean counters to increasingly slick purveyors of everything that corporate America needs?

During the 1970s and early 1980s, three major trends converged to change the scope and the nature of Big Eight practice. First, as the firms grew dramatically in size (mostly by gobbling up smaller practices across the nation), they found themselves supporting much larger overheads—higher salaries, expense accounts and office rents. Managing partners scurried to find new sources of business.

Second, there was a sudden softening in the firms' traditional market—the annual audit of major American corporations. The Big Eight's feedlot for generations, major audits had been as dependable as annuities. When this year's audit of Ford, General Motors or General Electric was complete, next year's would begin, assuring the accountants of a steady flow of revenue. And because only a few of the largest firms were deemed large enough to tackle a corporate giant on the scale of General Motors (which requires the services of up to 1,000 Deloitte Haskins & Sells accountants), the Big Eight monopolized what for years was a highly lucrative market.

THE BANK WAS PAYING PEAT MARWICK $70,000 A YEAR. TOUCHE ROSS BID $25,000.

This changed, however, as corporations started to strip away years of postwar waste and inefficiency. Materials and equipment suppliers were the first to feel the pressure, followed by professional firms. Suddenly, long-term audit relationships were threatened. Corporate financial officers—many of them Big Eight alumni seeded to clients to perpetuate long-term relationships—began to regard the auditors as ordinary service vendors rather than as old-school ties. For example, Price Stern Sloan, a Los Angeles publishing firm with $45 million in assets, departed Seidman & Seidman/BDO after 15 years for Coopers & Lybrand. The key to winning clients had changed from whom you knew to how much you charged, and competitive bidding, once unheard of in the genteel world of corporate auditing, became commonplace. Clients that had retained a Price Waterhouse or an Arthur Young for generations were now inviting all of the giants to compete for the audit, with the prize going to the lowest bidder. Overnight, the audit had become a commodity.

Instead of holding out against penny-pinching clients—refusing, as would prominent surgeons or attorneys, to work for marginal fees—the accountants fought for the crumbs, and fees dropped even lower. Art Bowman, editor of an industry newsletter, cites the case of Landmark Bancorp, a La Habra, California, firm with $154 million in assets, which had been paying Peat Marwick $70,000 annually for seven years. After a new bid was thrown to the Big Eight, Touche Ross ran off with the contract—for $25,000.

"Much of the open warfare for clients in recent years has been waged on the basis of price and price alone," says Donald Tannenbaum, managing partner of 16th-ranked Spicer & Oppenheim. "To wrestle clients away from competitors, the Big Eight routinely offer multiyear fixed-rate deals, whereby they'll agree to do audits for, say, $20,000 a year for three years. In many cases, that's well below their costs. But they'll take the work, absorbing the loss as the price of gaining entry to a client. That kind of cutthroat pricing has put pressure on everyone's audit practice."

Predictably, it has also made a lot of accountants mad. "That we have price wars over this is really insane," says Alan Westheimer of Pannell Kerr Forster. "It gives a professional service as much prestige as a supermarket loss leader."

The accounting industry has also been shaken up by a 1978 decision by the American Institute of Certified Public Accountants to end its longtime ban on accounting firms soliciting or advertising for business. This move to laissez-faire competition, made under pressure from the Federal Trade Commission, unleashed aggressive marketing practices that have rendered once-secure client relationships vulnerable to attack from competing firms. "When I started in this profession," says Charles Kaiser Jr., managing partner of Pannell Kerr Forster, "if auditor A received a call from a potential client—claiming it was being poorly serviced by auditor B—firm A would place a courtesy call to firm B asking whether there was any reason that A shouldn't see the client. Today, auditor A would be at the prospect's office the next morning no matter what firm B thought. In fact, A might even call the client on spec, hoping to lure the business away from B. In the past, that was unheard of. This took some of the stability out of audit engagements."

Audits remain valuable because they give a firm a foot in the door for selling other services. Admitted into a client's inner sanctum, a large accounting firm can then offer a laundry list of such services as human-resource planning, organizing analysis and computer consulting. And it is here, in what is generically known as Management Advisory Services, that the firms see their futures.

"Our increasingly technical society constantly needs to measure things, to analyze things and to make purchase, merger and investment decisions based on these measurements," says Ray Groves, chairman of Ernst & Whinney. "With a diversified pool of talent—14,000 people in the United States alone—we are in a unique position to satisfy that demand."

On the credit side of the ledger, the Big Eight have discovered that by evolving from reviewers of a client's past performance to advisers on its future, they were greatly increasing their revenue opportunities. They have also found that becoming such an adviser means becoming a better marketer. The chief executive officer of a hotel chain, believing that any big accounting firm can audit his corporation's books as well as any other, will probably base the selection of an auditor on price alone. He will be of a different mind when it comes to choosing consultants for advice on the feasibility of a new resort in Atlantic City. With a quarter of a billion dollars on the line, he will be looking for the firm with the best experience in the lodging business—no matter what the charge.

The American Institute of Certified Public Accountants requires all firms with "CPA" on the letterhead to count only CPAs as partners. How then do the Big Eight maintain their prized imprimaturs as "Certified Public Accountants" when a growing percentage of their partners don't know a depreciation schedule from a railroad timetable? Simply by substituting "principal" for "partner," applying this title to those who are equal to the CPA partners in salary and bonuses but who don't have a license to practice accounting.

Even the firms themselves can be confused by this subterfuge. Asked whether Touche Ross makes a distinction between the types of professionals on its payroll, a former managing partner said: "Absolutely not. There are no second-class citizens

here. We refer to our senior people as partners whether they are accountants or not." Advised that this violates the institute's rules, he paused. "I'll get back to you on that," he said, then called back moments later with a correction. "Only CPAs are partners. The others are principals. Disregard what I said before. I guess I wasn't aware of the rules."

Beyond the confusion, the expanding scope of practice raises serious issues. In their role as auditors, the firms are supposed to be independent of their clients, serving as watchdogs for the corporate and investment communities. In theory, at least, the auditor's signed opinion at the back of an annual report is based purely on impartial professional considerations.

The more deeply an accounting firm becomes enmeshed in a client's affairs, the harder it becomes to remain objective about the client's finances, no matter how honest and conscientious the auditor. "When a firm is performing every kind of auditing and consulting service for a major client—a corporation on the order of a General Motors, a Texaco or an IBM—it is earning tremendous fees from this relationship," says Steven Feldman, a former Arthur Andersen staff accountant and now president of Totsy Manufacturing in Holyoke, Massachusetts. "That's why there can be the suspicion—whether it's true or not—that management can sway the auditors to its point of view. With multimillion-dollar fees at stake, people are going to retain these suspicions."

This concerns Representative John Dingell, chairman of the House Subcommittee on Oversight and Investigations. "Independence is the one essential trait claimed by auditors that separates them from other professions," he said in a speech last year. "However, it is natural to ask how independent anybody can be when that person is hired, fired and paid by the people being audited. When I hear of lowball audit fees, of audits used as loss leaders to attract consulting business, that non-audit work is the wave of the future or that the top partners at major audit firms are management consultants, I frankly do not understand how that enhances the accounting profession's unique reputation for independent judgment as a public service."

More accountants are pushing for clearer rules to govern the delivery of consulting services to audit and non-audit clients. "I've said for years that I'd welcome participating in a panel charged with drawing the line on the scope of accounting-firm practice," says B.Z. Lee, special assistant to the chairman for Washington activities at the AICPA and a partner with 13th-ranked Seidman & Seidman/BDO. "But I've also said that I would participate only if the panel's recommendations would

stick. So far, no one is prepared to accept that. Probably because no one is prepared to stop growing."

Instead, the majority opinion holds that the firms should accept the new growth and the big fees and let the bureaucrats worry about appearances. "Anyone who says we sacrifice our independence or our reputation just because we provide a wide range of services is looking for an issue," says a Big Eight audit partner who requested anonymity.

The exploding scope of practice is transforming the cultures of the firms themselves. Salesmanship, once a dirty word to accountants, is now critical to the management process and, in many cases, has become the fastest route to promotion and partnership.

When Arthur Young or Touche Ross or Price Waterhouse wins a new audit client (more than likely on the basis of a loss-leader fee), it uses that opening to bombard the client with sales pitches designed to develop business for the firm's full inventory of services.

The Big Eight's infatuation with salesmanship may hold some benefits for clients who want to be spoon-fed their services, but the story is different for those partners who have been around since salesmanship was something that accountants frowned on. Having chosen accounting because it was the least commercial, most introverted profession, they now must step out of the closet and, at a senior stage in their careers, transform themselves into supersalesmen. Partners who have never sold a client anything, but who have been valued for their technical proficiency, now find that they are relics of another age. "Technical competence is no longer enough to make it in this profession," says Charles Kaiser, managing partner of Pannell Kerr Forster. "Proficiency at your skill is a given, a minimum standard. Today you also have to bring in clients or service them well."

Until the early 1980s, the Big Eight were run like universities, with the senior partners enthroned in tenured positions that virtually guaranteed their jobs and their salaries. But as the firms traded in the old vision of themselves as scholarly fraternities for corporate-style meritocracy, Darwinian selection replaced seniority as the basis for rank and compensation.

"Just a few years ago, you could tell how much a partner was earning by asking how many years he'd been with a place," says Deloitte Haskins & Sells' chairman, Michael Cook, who is widely credited with breathing new life into the firm. "Like clockwork, he'd get a reliable increase ev-

HOW THE BIG EIGHT RATE

Don't be fooled by all those gray suits. The major accounting firms may look like clones from the outside, but they vary greatly in size, business emphasis and—most important—personality. Here is an unfettered view from inside.

Firm	Offices	1987 Worldwide Revenues*	Sources of Revenues		Comments
1 Peat Marwick New York	600	$3.25 billion	Auditing and Accounting Tax Management Advisory Services	67% 21% 12%	Solid accounting practice with good management advisory services division. Rich in talented partners. Recently preoccupied with implementing a merger with the second-tier firm of Main Hurdman.
2 Arthur Andersen Chicago	226	2.3 billion	Auditing and Accounting Tax Management Advisory Services	43% 21% 36%	Very solid firm, but one with an arrogant mentality. Insists that you do it the Andersen way or not at all.
3 Ernst & Whinney Cleveland	421	1.78 billion	Auditing and Accounting Tax Management Advisory Services	51% 22% 27%	Typical Midwestern mentality. Favors nose-to-grindstone hard work over flashy marketing and promotion.
4 Price Waterhouse New York	400	1.75 billion	Auditing and Accounting Tax Management Advisory Services	58% 24% 18%	Stodgy and successful, it considers itself elite. It has the highest partner earnings in the Big Eight. Has some prestigious clients and retains a lingering white-shoe culture.
5 Arthur Young New York	93	1.70 billion	Auditing and Accounting Tax Management Advisory Services	58% 22% 20%	Top-rated auditors. It straddles the fence between commercial and professional ambitions, undecided as to which side it wants to sit on.
6 Coopers & Lybrand New York	550	1.65 billion	Auditing and Accounting Tax Management Advisory Services	58% 22% 20%	Highly aggressive, at the cutting edge of management advisory services. Generally regarded as having top-rated consultants on staff.
7 Deloitte Haskins & Sells New York	440	1.5 billion	Auditing and Accounting Tax Management Advisory Services	65% 19% 17%	Strong leadership, but some deadwood in the partnership ranks. Struggling to escape its stodgy past, and would benefit from an intra-Big Eight merger.
8 Touche Ross New York	490	1.45 billion	Auditing and Accounting Tax Management Advisory Services	55% 22% 23%	The firm's performance is improving under new leadership but is still uneven, with results better in major offices than in satellites. Aggressive in expanding management advisory services. It has an inferiority complex toward larger firms. Yearns to be larger and more prestigious.

(Source: Public Accounting Report)

ery year. Once he reached a certain level, those increases bore little relationship to performance. Today, if you want to know how much a partner earns, you have to ask about his current contribution to the firm. Performance is far more important than seniority."

Seidman's B.Z. Lee says much the same thing. "In the past, being made a partner was like gaining entry to the royal family," he says. "Once you made it, you were there until retirement. But things have changed. Today, if you don't perform, you can be excommunicated."

The downside of this emphasis on salesmanship is that it is gradually forcing out the fastidious CPAs who cross their t's and dot their i's. "The guys in charge of Big Eight audits today are very bottom-line oriented," says a senior partner with New York's Spicer & Oppenheim. "That's how they got their jobs. They'll do whatever is necessary to make a profit on the engagements. But they're caught in a cross fire. Because management has quoted low-ball fees, making money on the job is impossible—impossible, that is, unless the firm cuts corners on the audit, limiting the scope of its review below prudent levels and crossing its fingers that everything will turn out all right. With people on the job more concerned with profits than with quality, the chance for serious errors and oversights is always great."

An October 1987 report by the National Commission on Fraudulent Financial Reporting supports this. The group, which was headed by James Treadway, former commissioner of the Securities and Exchange Commission, found that fee and budget pressures detract from audit quality and make it possible for fraud to slip by undetected. "Intense competition among accounting firms contributes to significant pressure on audit fees, often with corresponding pressure to reduce staff, time budgets and partner involvement in audit engagements," the report said.

The downgrading of technical gurus only increases the likelihood of sloppy and unreliable audits. "As the Big Eight cultures have turned increasingly business-like, technical guys have found themselves falling from grace," says a retired Big Eight partner who keeps tabs on the firm through a network of former colleagues.

Kim Putman, editor of *Public Accounting Report*, a widely followed industry newsletter, has noticed the same thing. "Until recently, when accountants talked about their work, they referred to it as 'the profession,' " she says. "Today they call it 'the business.' " A matter of semantics? No, it's more than that. It reflects the transition to a corporate-style culture that is spreading throughout the Big Eight. ■

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